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92-1152

Case No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

WESTERN GAS RESOURCES, INC.,
SUCCESSOR IN INTEREST TO
WESTERN GAS PROCESSORS, LTD.,

Petitioner,

v.

M. K. HEIDI HEITKAMP,
TAX COMMISSIONER OF THE
STATE OF NORTH DAKOTA,

Respondent.

Petition For Writ Of Certiorari
To The North Dakota Supreme Court

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether Western Gas Resources, Inc.'s constitutional rights to due process of law as guaranteed by the United States Constitution have been violated as a result of the North Dakota Tax Commissioner's and the North Dakota Supreme Court's interpretation and implementation of the North Dakota Oil Extraction Tax with regard to taxing condensate produced by Western in its natural gas gathering system and compression facilities.

LIST OF PARTIES

Petitioner (Plaintiff-Appellant):

Western Gas Resources, Inc. is the Successor in Interest to Western Gas Processors, Ltd.

Respondent (Defendant-Appellees):

M. K. Heidi Heitkamp, Tax Commissioner of the State of North Dakota

Western Gas Resources, Inc. has no parent company or non-wholly owned subsidiaries.

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I. REPORT OF OPINIONS

1. Findings of Fact and Conclusions of Law dated May 8, 1991, by Allen C. Hoberg, Assistant Attorney General and Hearing Officer for the State of North Dakota. Not Reported.

2. Letter dated May 22, 1991, from North Dakota Tax Commissioner to all counsel concerning changes to and adoption of the Findings of Fact and Conclusions of Law. Not Reported.

3. Order of the State of North Dakota, State Tax Commissioner, imposing the Oil Extraction Tax dated May 22, 1991. Not Reported.

4. Memorandum Decision dated November 14, 1991, by Judge William F. Hodny of the District Court of the South Central Judicial District, County of Burleigh, State of North Dakota. Not Reported.

5. Judgment of the District Court of the South Central Judicial District, County of Burleigh, State of North Dakota dated November 25, 1991. Not Reported.

6. Notice of Entry of Judgment of the District Court for the South Central Judicial District, County of Burleigh, State of North Dakota dated November 25, 1992. Not Reported.

7. Decision of the North Dakota Supreme Court dated August 19, 1992. Reported at 489 N.W.2d 869 (N.D. 1992).

8. Order of the North Dakota Supreme Court dated October 1, 1992, denying Western's Petition for Rehearing. Not Reported.

9. The Mandate of the North Dakota Supreme Court dated October 12, 1992. Not Reported.

II. GROUNDS FOR JURISDICTION

On August 19, 1992, the North Dakota Supreme Court affirmed the decision of the North Dakota District Court finding that the interpretation and implementation of the North Dakota

Oil Extraction Tax ("OET") did not violate Western's United States Constitutional right to due process. The North Dakota Supreme Court denied Western's Petition for Rehearing on October 1, 1992. The Mandate of the North Dakota Supreme Court was entered on October 12, 1992. Western asserts that the United States Supreme Court has jurisdiction pursuant to 28 U.S.C. § 1257.

III. CONSTITUTIONAL PROVISIONS AND STATUTES

ARTICLE V

> **Grand jury — indictment — jeopardy — process of law — taking property for public use.** No person shall be held to answer for a capital or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service, in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled, in any criminal case, to be a witness against himself; nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.

U.S. Constitution, Article V.

ARTICLE XIV

> § 1. **Citizenship defined — privileges of citizens.** All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of

life, liberty or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. Constitution, Article XIV, § 1.

N.D.C.C. § 57-51.1-01

Definitions for Oil Extraction Tax. For the purposes of the oil extraction tax law, the following words and terms shall have the meaning ascribed to them in this section:

3. "Oil" means petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas.

N.D.C.C. § 57-51.1-02

Imposition of Oil Extraction Tax. There is hereby imposed an excise tax, to be known as the "oil extraction tax", upon the activity in this state of extracting oil from the earth, and every owner, including any royalty owner, of any part of the oil extracted shall be deemed for the purposes of this chapter to be engaged in the activity of extracting that oil. The rate of tax shall be six and one-half percent of the gross value at the well of the oil extracted, ...

N.D.C.C. § 57-51-05

2. On oil or gas sold at the time of production, the gross production tax thereon shall be paid by the purchaser, and such purchaser shall and is hereby authorized to deduct in making settlement with the producer or royalty owner, the amount of tax so paid; provided, that in the event oil on which such gross production tax becomes due is not sold at the time of production but is retained by the producer, the tax on such oil not so sold shall be paid by the producer for himself including the

tax due on royalty oil not sold; provided further, that in settlement with the royalty owner such producer shall have the right to deduct the amount of such tax so paid on royalty oil or to deduct therefrom royalty oil equivalent in value at the time such tax becomes due with the amount of the tax paid.

N.D.C.C. § 57-51.1-05

For the purposes of administering the tax imposed by section 57-51.1-02, the provisions of chapter 57-51 pertaining to the administration of the oil and gas gross production tax law not in conflict with the provisions of this chapter, including but not limited to the provisions of that chapter relating to the filing of returns, deduction of the tax by the purchaser or producer in making settlement with any owner of the oil, payment of the tax and interest and penalties thereon, refunds, attachment of liens for failure to pay the tax, and civil and criminal penalties for failure to comply with the provisions of that chapter, shall govern the administration of the tax imposed by section 57-51.1-02.

IV. STATEMENT OF THE CASE

On January 29 and 30, 1991, this case was heard before Allen C. Hoberg, the hearing officer appointed by the Tax Commissioner, in regard to the Notice of Determination issued by the Tax Commissioner on October 18, 1985. The Notice of Determination at issue assessed Gross Production and Oil Extraction Taxes, penalty and interest, for the period of November 1979 through December 1983 (Appendix, Part K). Western challenged the Notice of Determination on various grounds including that it was unconstitutionally vague (Appendix, Part L, Nos. 40 and 45). The hearing officer made certain proposed findings of fact and conclusions of law and submitted them to the Tax Commissioner and the parties on May 8, 1991 (Appendix, Part E). Thereafter, on May 22, 1991, the Tax Commissioner

entered her order imposing the OET (Appendix, Part G). In support of her order, the Tax Commissioner in large part adopted the findings of fact and conclusions of law of the hearing officer which did not address the constitutionality of the OET since administrative agencies, such as the Tax Commissioner's office, do not have authority under North Dakota law to declare statutes unconstitutional. *First Bank of Buffalo v. Conrad*, 350 N.W.2d 580, 585 (N.D. 1984).

Western appealed the order of the Tax Commissioner to the District Court, South Central Judicial District, County of Burleigh, State of North Dakota, in Civil Action No. 91-C-1538 (Appendix, Part M). In the Appeal, Western specifically challenged the constitutionality of the OET as violative of Western's right to due process (Appendix, Part M, Nos. 4-7). Subsequently, the District Court entered its judgment and affirmed the decision of the Tax Commissioner on November 25, 1991, noting that "After the application of rudimentary rules of construction, the meaning of the statute is fairly ascertainable from the viewpoint of a reasonable person subject to its terms. Legal arguments may cloud the issue, but the rules of construction have dissipated those clouds, and any due process violation" (Appendix, Part C, page C-2). Western timely filed its Notice of Appeal to the North Dakota Supreme Court. In its opening brief, Western specifically stated as an issue for review "Whether Western's constitutional rights to due process of law have been violated by the Tax Commissioner's arbitrary, capricious and unreasonable interpretation and implementation of the Oil Extraction Tax ("OET"), thereby rendering the OET unenforceable against Western" (Opening Brief, page 1). On August 19, 1992, the North Dakota Supreme Court held in favor of the Tax Commissioner, specifically finding that the OET "provides adequate notice of the meaning of 'on the lease' " and therefore did not violate Western's right to due process (Appendix, Part A, pages A-7 – A-8). Western filed a Petition for Rehearing which was denied on October 1, 1992 (Appendix, Part H). The North Dakota Supreme Court issued its Mandate on October 12, 1992 (Appendix, Part J).

1. WESTERN'S BUSINESS.

Western is involved in the business of gathering, compressing, processing, transporting and marketing natural gas and natural gas liquids. Western does not own interests in oil or gas wells in North Dakota and is thus not a producer of oil or gas in North Dakota. Western simply purchases natural gas from various producers at the wellsite. Starting with the wellsite, the producer's pumping unit withdraws gas, oil and water from the earth, which is then passed through a separator. The separator separates the oil, gas and water phases. The oil goes to a stock tank where it is later trucked or piped out of the area. The producer disposes of the water by hauling it from the lease site. The gas is taken from the top of the separator and flows through the custody transfer meter and into Western's extensive gathering system.

The condensate which is the subject of this case passes through the custody transfer meter at the wellsite in vapor form and is a component of the gas stream for which Western pays the producer. Title and risk of loss pass from the producer to Western at the custody transfer meter. As a result of Western's design and construction of its gathering system and compression facilities, the condensate at issue in this case, after passing through the custody transfer meter in gaseous form, is produced in the gathering system and compression facilities prior to the inlet of Western's processing facility known as the Teddy Roosevelt processing facility. The gathering system consists of many miles of pipeline through which the gas stream flows enroute to the processing facility. The compression facilities are located at various points throughout the gathering system.

At the Teddy Roosevelt processing facility, the gas and liquids are treated to remove contaminants such as hydrogen sulfide. Some of the liquids are stabilized to make them easily storable and saleable as stock tank liquid, and the remaining natural gas liquid components removed from the gas stream are fractionated, producing a variety of natural gas liquids such as propane, butane and some natural gasoline.

2. ASSESSMENT OF TAX ON CONDENSATE.

The tax in question is an excise tax based upon the activity of extraction of oil from the earth. It is undisputed that the point at which the condensate in this case is produced is after extraction of oil at the lease site, as all production activities by Western occur after the gas passes through the custody transfer meter. It is also undisputed that Western is not involved in any way in the activity of extracting oil from the earth. Furthermore, the producers are not involved in the activity of extracting oil from the earth in regard to the production of the condensate produced in Western's gathering system and compression facilities.

Western received a Notice of Determination from the Tax Commissioner for Gross Production Tax and OET dated October 18, 1985 (Appendix, Part K). The October 18, 1985, Notice of Determination assessed Gross Production Tax, including penalties and interest, of $258,967.95, and OET, including penalties and interest, of $708,384.01, for a total assessment of $967,351.96. On January 10, 1991, the Tax Commissioner reduced the remaining assessment dated October 18, 1985, to $277,203.48, which amount includes penalty and interest. This final assessment was for OET only.

During the entire time period at issue, the Tax Department accepted the taxes paid by the producers in this case. At least in part because of the size of the assessment against Western and Western's conclusion that it would have deprived the producers and royalty owners of substantial revenue to which they were entitled if Western had paid the tax as originally assessed, Western has not made deductions from the amounts paid its producers for the taxes assessed by the Tax Commissioner. In addition, the producers which existed during the relevant time period of the assessment, i.e., November 1979 through December 1983, changed over time, and some of the producers are in bankruptcy, making recoupment of the tax virtually impossible.

V. ARGUMENT

WESTERN'S CONSTITUTIONAL RIGHTS TO DUE PROCESS OF LAW HAVE BEEN VIOLATED.

Western's constitutional rights to due process of law have been violated by the Tax Commissioner's and North Dakota Supreme Court's interpretation and implementation of the Oil Extraction Tax, thereby rendering the Oil Extraction Tax unenforceable against Western.

1. Due Process Requirement and Strict Construction Requirements.

In regard to the interpretation of taxing statutes, "it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt, they are construed most strongly against the Government, and in favor of the citizen." *Gould v. Gould*, 245 U.S. 151, 153, 62 L. Ed. 211, 38 S. Ct. 53 (1915). The *Gould* principle has been specifically recognized by the North Dakota Supreme Court in *Great Northern Railway Co. v. Flaten*, 225 N.W.2d 75 (N.D. 1975), when the court stated:

> The best that can be said of this statute is that it contains an ambiguity on the question of the term for which the excess levy is authorized. Where legislative intention is doubtful with respect to the meaning of the statutes granting taxing authority, the doubt must be resolved against the government and in favor of the taxpayer. See *Goldberg v. Gray*, 70 N.D. 663, 297 N.W. 124 (1941); *Great Northern Railway Co. v. Severson, supra; Standard Oil Co. of Indiana v. State Tax Comm'r*, 71 N.D. 146, 299 N.W. 447 (1941). The power to impose taxes should not be extended beyond the clear meaning of the statutes. *Id.* at 78.

This Court further examined the issue in *White v. Aronson*, 302 U.S. 16, 20-21, 82 L. Ed. 20, 58 S. Ct. 95 (1937), in which this

Court quoted from *Philadelphia Storage Battery Co. v. Lederer*, 21 F.2d 320, 321-22 (E.D. Pa. 1927), that "Tax laws, like all other laws, are made to be obeyed. They should therefore be intelligible to those who are expected to obey them." This requirement of intelligibility in regard to tax laws is particularly germane to the OET which contains a clear limitation that only those products produced "on the lease" are subject to the tax. The North Dakota Tax Commissioner and North Dakota Supreme Court, however, have ignored the commonly accepted meaning of "on the lease" in order to impose the OET on condensate produced by Western.

2. The OET and the Tax Commissioner's Interpretation.

Based upon the foregoing, it becomes important to examine the language of the OET, the record in this case, and the manner in which the statute has been interpreted and implemented by the Tax Commissioner and the North Dakota Supreme Court. The relevant statutory sections state as follows:

> N.D.C.C. § 57-51.1-01
>
> Definitions for Oil Extraction Tax. For the purposes of the oil extraction tax law, the following words and terms shall have the meaning ascribed to them in this section:
>
> 3. "Oil" means petroleum, crude oil, mineral oil, casinghead gasoline, and all liquid hydrocarbons that are recovered from gas on the lease incidental to the production of the gas.
>
> N.D.C.C. § 57-51.1-02
>
> Imposition of Oil Extraction Tax. There is hereby imposed an excise tax, to be known as the "oil extraction tax", upon the activity in this state of extracting oil from the earth, and every owner, including any royalty owner, of any part of the oil extracted shall be deemed for the purposes of this chapter to be engaged in the activity of extracting that oil. The rate of tax shall be six

> and one-half percent of the gross value at the well of the oil extracted, ...

N.D.C.C. § 57-51-05

> 2. On oil or gas sold at the time of production, the gross production tax thereon shall be paid by the purchaser, and such purchaser shall and is hereby authorized to deduct in making settlement with the producer or royalty owner, the amount of tax so paid; provided, that in the event oil on which such gross production tax becomes due is not sold at the time of production but is retained by the producer, the tax on such oil not so sold shall be paid by the producer for himself including the tax due on royalty oil not sold; provided further, that in settlement with the royalty owner such producer shall have the right to deduct the amount of such tax so paid on royalty oil or to deduct therefrom royalty oil equivalent in value at the time such tax becomes due with the amount of the tax paid.

Likewise, in relation to the OET, § 57-51.1-05 states as follows:

> For the purposes of administering the tax imposed by section 57-51.1-02, the provisions of chapter 57-51 pertaining to the administration of the oil and gas gross production tax law not in conflict with the provisions of this chapter, including but not limited to the provisions of that chapter relating to the filing of returns, deduction of the tax by the purchaser or producer in making settlement with any owner of the oil, payment of the tax and interest and penalties thereon, refunds, attachment of liens for failure to pay the tax, and civil and criminal penalties for failure to comply with the provisions of that chapter, shall govern the administration of the tax imposed by section 57-51.1-02.

In analyzing the Tax Commissioner's and North Dakota Supreme Court's interpretation and implementation of the OET,

it is important at the outset to recognize that the Tax Commissioner testified in this case that the OET is ambiguous. The North Dakota Supreme Court agreed (Appendix, Part A, page A-5).

Given the fact that the North Dakota Supreme Court's position is that the statute is ambiguous, it nonetheless interprets the statute to impose liability on Western for production of condensate produced off the lease. In order to reach this conclusion, the North Dakota Supreme Court held that the condensate at issue in this case constitutes oil within the definition contained in the OET. The North Dakota Supreme Court has interpreted the phrase "on the lease" as contained in the OET to refer to all liquid hydrocarbons that are recovered before the inlet of the processing facility and therefore to mean that only refined products produced subsequent to the inlet of a gas processing facility are excluded from the OET (Appendix, Part A, page A-7).

Given the fact that the condensate is produced in the gathering system and compressor stations of Western and not the processing facility, an analysis of the phrase "on the lease" is of paramount importance. An examination of the record in this case clearly shows that "on the lease" is a phrase that means at the wellsite and the custody transfer meter. Once the gas has passed through the custody transfer meter, all activities are then commonly understood to be off the lease. Every witness and industry expert who testified agreed, including the Tax Commissioner's principal expert witness who testified that he had never heard of another definition of "on the lease" (State's witnesses: Appendix, Parts O and P) (Western's witnesses: Appendix, Parts Q and R).

3. Denial of Due Process.

As demonstrated by the foregoing analysis, the Tax Commissioner's and North Dakota Supreme Court's interpretation of the OET results in a denial of due process to Western and therefore renders the OET unenforceable against Western. The "on the lease" provision clearly means that the OET has no

applicability to condensate produced off the lease. However, if the statute is interpreted as being ambiguous on this point, then all doubt concerning the statute must be resolved in Western's favor. The analysis of the unconstitutionality of the OET may be reduced to seeking the answer to a single question, i.e., does the OET give Western adequate notice or warning that products produced off the lease are subject to taxation? Under both a reasonable person's and an industry expert's reading of the statute, the answer to this question is clearly no.

The result to Western based upon the North Dakota Supreme Court's opinion is particularly egregious when it is recognized that Western has been, in essence, designated by the legislature to be the Tax Commissioner's agent for collection of the OET. Clearly, Western is not the party that is intended by the statutory scheme to be the one primarily liable for the tax. It is a producer's tax and Western is not a producer. Under these circumstances Western is entitled to clear notice of its obligation to collect the tax. Such notice is particularly critical when, as occurred here, the Tax Commissioner, years after the fact, imposed the tax liability on Western as Western did not pay the tax in the first instance and deduct the amount of the tax from its settlement payments to the producers. In this case, the Notice of Determination at issue was sent on October 18, 1985, and applies to a period commencing some six years prior in November 1979.

VI. CONCLUSION

In conclusion, it is submitted that the record in this case supports the following:

1. The determining factor as to whether the condensate in this case is subject to the Oil Extraction Tax is the location at which it is produced.

2. The term, "on the lease", as contained in the Oil Extraction Tax means the wellsite and custody transfer meter.

3. All witnesses including expert witnesses in this case testified that the meaning of the term "on the lease" is the wellsite and custody transfer meter.

4. The condensate in this case is produced after the gas passes through the custody transfer meter into the gathering system and compression facilities of Western and is therefore not produced on the lease.

Given the foregoing, the Tax Commissioner's and North Dakota Supreme Court's interpretation of the Oil Extraction Tax is contrary to the plain meaning of the statute as understood by a reasonable person reading the statute. As such, Western received no notice of its statutory obligations. The result is that a tax originally designed to be imposed on the producer has been imposed on Western in contravention of Western's constitutional rights to due process.

Western therefore requests that this Court grant its Petition for Writ of Certiorari and review this case in its entirety.

Respectfully submitted,

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